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Supreme Court, U.S.
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Case No. 88-647

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

IN RE:

JACK R. WHITEHORN and
MARY RUTH WHITEHORN,

Debtors,

JACK R. WHITEHORN and
MARY RUTH WHITEHORN,

Petitioners,

vs.

MARGARET H. MURPHY and
SMITH, GAMBRELL & RUSSELL,

Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the United States District Court and the United States Court of Appeals appropriately affirmed the Bankruptcy Court's determination that the Petitioners' rights were previously determined by a final order of the United States Bankruptcy Court for the Northern District of Georgia and that the relief requested is consequently precluded by the doctrine of *res judicata.*

2. Whether cancellation of Petitioners' stock in exchange for certificates of interest was stayed by operation of 11 U.S.C. § 362 upon the filing of Petitioners' individual Chapter 11 petition.

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BRIEF IN OPPOSITION

DECISION BELOW

The May 26, 1988, decision of the United States Court of Appeals in case no. 88-8018 affirming the decision of the district court is unreported. The December 21, 1987 decision of the United States District Court for the Northern District of Georgia affirming the order of the bankruptcy court is unreported. The July 31, 1987 order of the United States Bankruptcy Court for the Northern District of Georgia in favor of Respondents is unreported.

STATUTORY PROVISIONS INVOLVED

This case involves 11 U.S.C. § 1141:

Effect of Confirmation

(a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan —

> (A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h) or 502(i) of this title, whether or not —

(i) a proof of claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan; and

(B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

(2) The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title.

(3) The confirmation of a plan does not discharge a debtor if —

(A) The plan provides for the liquidation of all or substantially all of the property of the estate;

(B) The debtor does not engage in business after consummation of the plan; and

(C) The debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title.

(4) The court may approve a written waiver of discharge executed by the debtor after the order for relief under this chapter.

This case also involves 11 U.S.C. § 1109:

Right to be Heard

(a) The Securities and Exchange Commission may raise and may appear and be heard on any issue in a

case under this chapter, but the Securities and Exchange Commission may not appeal from any judgment, order, or decree entered in the case.

(b) A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.

STATEMENT OF THE CASE

Jack R. Whitehorn and Mary Ruth Whitehorn (hereinafter collectively "Petitioners") filed a Complaint to Compel Turnover on April 3, 1986, in the United States Bankruptcy Court for the District of Nevada (hereinafter the "Complaint"). The Complaint demanded turnover of certain stock of WFDR, Inc. (hereinafter "WFDR") allegedly in the possession of Margaret H. Murphy, and the law firm of Smith, Cohen, Ringel, Kohler & Martin (now known as Smith, Gambrell & Russell) (hereinafter collectively the "Respondents")[1], as well as "all assets said stock owns," alleging that the stock and assets constituted property of Petitioners. On December 17, 1986, the United States Bankruptcy Court for the District of Nevada entered an order granting the Respondents' motion to transfer the Complaint to the Northern District of Georgia.

Both the Petitioners and the Respondents filed motions for summary judgment. The Honorable United States Bankruptcy Judge W. Homer Drake entered judgment in favor of Respondents on July 31, 1987, holding Petitioners' claims were barred by the doctrine of *res judicata*. Petitioners appealed the judgment. The United States District Court for

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[1] Respondents acted as counsel to WFDR in its bankruptcy case and related proceedings. Respondent Murphy assumed her duties as United States Bankruptcy Judge for the Northern District of Georgia on October 19, 1987.

the Northern District of Georgia, Judge G. Ernest Tidwell, affirmed the bankruptcy court's decision on December 21, 1987.[2]

Petitioners thereafter perfected an appeal to the United States Court of Appeals for the Eleventh Circuit. The court of appeals affirmed the district court's order. The court of appeals also concluded that the appeal was "frivolous," and awarded double costs against Petitioners. Rehearing in banc was denied.[3]

The facts preceding the filing of the Complaint are not in dispute, the bankruptcy court having resolved these matters on cross-motions for summary judgment.[4]

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[2] The Complaint was originally mischaracterized as a turnover action under 11 U.S.C. § 542. If an action at all, the Complaint is an action under 11 U.S.C. § 549. *See Blanton* v. *Graham*, 35 Bankr. 15, 17 (Bankr. D.S.C. 1983); *Administrator of Veterans Affairs* v. *Bernard*, 21 Bankr. 287, 289 (Bankr. E.D.Pa. 1982); *Russell* v. *Equibank*, 8 Bankr. 342 (Bankr. W.D.Pa. 1980). Although Petitioners' prayer for relief seeks "turnover," the appropriate standard for determining the nature of an action is the underlying premise of the action, not the relief sought by the prayer. Although the remedy Petitioners seek is "turnover," from the standpoint of the Bankruptcy Code, Petitioners are seeking to avoid a transfer that occurred subsequent to the filing of their Chapter 11 petition, allegedly in violation of the automatic stay. The Complaint, however, is time barred because the action was not commenced within two years of the alleged voidable transfer. 11 U.S.C. § 549(d)(1). The cancellation of Petitioners' stock, the transfer sought to be avoided, occurred upon confirmation of the Amended Plan on or about June 29, 1981. The effective date of the Amended Plan was August 18, 1981, four and one-half years prior to the filing of the Complaint. Summary judgment was therefore properly granted in favor of the Respondents. *See Franke* v. *S.M.R.S., Inc. (In re Burstein-Applebee Company)*, 30 Bankr. 779, 780 (Bankr. W.D. Mo. 1983). The district court did not address the statute of limitations issue because of the favorable ruling on *res judicata*.

[3] While the suggestion of rehearing in banc was pending, Petitioners filed another action against Respondents in the United States District Court, District of Nevada, Civil Action File No. CV-S-88-541 (RJJ).

[4] The following account is based on the bankruptcy court's July 31, 1987, order. (Petitioners' Appendix at 60).

On March 28, 1980, Petitioner Jack Whitehorn executed a certain Stock Option Agreement in favor of his brother, Dr. John Whitehorn (hereinafter the "Stock Option Agreement"). The Stock Option Agreement included a proxy granting voting authority over Petitioners' 100% stock interest in WFDR, and an option to acquire Petitioners' stock in WFDR.

On May 9, 1980, WFDR filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code, case no. 80-00136N, in the United States Bankruptcy Court for the Northern District of Georgia. After unsuccessfully challenging various aspects of the WFDR Chapter 11 proceeding, Petitioners filed a voluntary individual petition under Chapter 11 in Nevada on October 6, 1980.

On July 22, 1980, in the Northern District of Georgia, and on December 11, 1980, in the District of Nevada, Petitioners initiated adversary proceedings against Dr. John Whitehorn contesting ownership of the stock and control of WFDR. On January 30, 1981, the Nevada court transferred the Nevada adversary proceeding to the Northern District of Georgia for consolidation.

On January 30, 1981, WFDR filed an application to liquidate its assets in the United States Bankruptcy Court for the Northern District of Georgia. Petitioners objected to the application both as alleged creditors of WFDR and claiming sole ownership of WFDR. Following notice and a hearing, the bankruptcy court entered an order on March 16, 1981, approving the sale of assets for $790,000.00 to Lake George Corporation, predecessor in interest to Provident Broadcasting Company (hereinafter "Provident"). On April 8, 1981, the bankruptcy court denied Petitioners' motions for a new trial, for alteration or amendment of the judgment, and for additional findings of fact. Petitioners appealed both orders (hereinafter collectively the "Orders Approving the Sale of Assets"), but did not seek a stay of the sale pending resolution of the appeal.

On May 27, 1981, WFDR filed an Amended Plan of Reorganization (hereinafter the "Amended Plan") which, upon confirmation, would implement the Orders Approving the Sale of Assets by cancelling the outstanding stock of WFDR. Holders of stock, including Petitioners, would receive certificates of interest evidencing entitlement to the net proceeds of the liquidation, after payment of debts and claims owing by WFDR.

Petitioners filed objections to the disclosure statement and to confirmation of the Amended Plan on the grounds, *inter alia*, that the management of WFDR lacked the requisite corporate authority to file the Chapter 11 petition. On June 29, 1981, the bankruptcy court entered an order confirming the Amended Plan over Petitioners' objections. In the order confirming the Amended Plan, the bankruptcy court acknowledged the pending adversary proceeding between Petitioners and John Whitehorn concerning the ownership of WFDR, but stated that even if "Jack Whitehorn is proven to be the owner of all the stock of WFDR, Inc., despite his objection to the plan of reorganization, the plan should be confirmed pursuant to 11 U.S.C. § 1129(b)(2)(C)." No appeal was filed from the order confirming the Amended Plan. The Amended Plan was thereafter fully consummated.

By order dated September 18, 1981, the United States District Court for the Northern District of Georgia dismissed Petitioners' appeal of the Orders Approving the Sale of Assets as moot "in that the amended plan providing for the sale of the stock in lieu of a sale of the assets has been approved and consummated." The district court also noted that the order approving the sale of stock had not been appealed and no stay of the sale had been obtained. On August 17, 1983, the United States Court of Appeals for the Eleventh Circuit affirmed the district court's order dismissing Petitioners' appeal as moot because the order confirming the Amended Plan had not been appealed and because the sale authorized and implemented by the Amended Plan was not stayed.

On July 14, 1983, Respondents and the Committee of Unsecured Creditors of WFDR jointly filed an application to settle certain claims against the WFDR estate. The application provided, among other things, that upon partial payment of certain administrative and unsecured claims of Dr. John Whitehorn, Dr. John Whitehorn would relinquish any claim to proceeds of the shares of WFDR cancelled pursuant to the provisions of the Amended Plan. The application further provided that Petitioners' ownership interest in WFDR, evidenced by the newly issued certificates of interest tendered in exchange for the cancelled shares, was to be redeemed by the payment of $35,000 from the proceeds generated subsequent to the sale to Provident. On January 26, 1984, the bankruptcy court approved the settlement in recognition and satisfaction of Petitioners' interest in WFDR. Proceeds from the liquidation were paid to Petitioners' attorneys for the benefit of Petitioners' individual estate upon specific authorization by order of the United States Bankruptcy Court for the District of Nevada. On November 15, 1984, a final decree was entered closing the estate of WFDR.

SUMMARY OF THE ARGUMENT

The Amended Plan, having been confirmed and consummated, is *res judicata* as to all issues raised by Petitioners in the instant Petition, including the issue of whether cancellation of the stock was stayed by operation of law. That issue should have been raised at the confirmation hearing on the WFDR plan of reorganization, and cannot be used as a collateral attack on the Amended Plan.

The cancellation of stock held by an individual in Chapter 11 and substitution of certificates of interest by a corporation pursuant to the laws of the state of its incorporation and pursuant to an order of a United States Bankruptcy Court is not an action stayed by operation of 11 U.S.C. § 362. Petitioners' property rights were not altered by the cancellation and substitution. Only the form of the tangible evidence of Petitioners' equity interest was changed.

REASONS FOR DENYING THE WRIT

The Petition follows the determination by the Court of Appeals that the appeal to that court was frivolous. Consistent with that finding, Petitioners have failed to establish a reason for granting the Writ.

The decision below is consistent with decisions of other federal courts of appeals and the accepted and usual course of judicial proceedings. This case does not involve an important question of federal law which should be settled by this Court, and the decision below is in harmony with the applicable decisions of this Court. Moreover, the facts and procedural background of this case are so unique as to eliminate any significant precedential value of a review on the merits by this Court.

A. The courts below correctly applied settled law in holding the Complaint is barred by the doctrine of res judicata.

All of the relevant claims and issues raised by the Complaint were previously addressed (or would have been addressed if raised) by the bankruptcy court in the WFDR bankruptcy case through the confirmation of the Amended Plan. The effect of the automatic stay on the WFDR reorganization should have been litigated seven years ago, if at all. The defense, even if meritorious, is now barred and superceded by the confirmation and consummation of the Amended Plan. Although Petitioners, who at the time were represented by counsel, objected to confirmation of the Amended Plan, they failed to raise the issue of the automatic stay. Moreover, Petitioners did not appeal the confirmation order.

Confirmed plans of reorganization have a binding *res judicata* effect on all parties.

> [T]he provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and

> any creditor, *equity security holder*, or general partner in the debtor whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

11 U.S.C. § 1141(a) (emphasis added). All issues raised and all issues that could have been plead in objection to confirmation of the Amended Plan are *res judicata* and cannot now be asserted as a collateral attack on the Amended Plan. *See Southmark Properties* v. *Charles House Corporation*, 742 F.2d 862 (5th Cir. 1984). *See also* 5 Collier on Bankruptcy ¶ 1141.01[1] (15th ed. 1987). *Res judicata* not only bars claims that actually were litigated in a previous proceeding, but reaches beyond the scope of collateral estoppel and bars litigation of claims that *could have been* litigated in the previous action. *Hotel Corp. of the South* v. *Rampart 920, Inc.*, 46 Bankr. 758, 767 (E.D. La. 1985), *aff'd*, 781 F.2d 901 (5th Cir. 1986). All of the issues raised by Petitioners, including the effect of the automatic stay, should have and could have been raised and litigated as objections to the Amended Plan.

The *Southmark Properties* decision is particularly apposite. In *Southmark Properties*, the United States Court of Appeals for the Fifth Circuit applied the doctrine of *res judicata* to a factual circumstance substantially similar to that of the instant proceeding and barred relitigation of all issues that could have been raised as objections to confirmation. In *Southmark Properties*, the president and majority shareholder of the debtor corporation objected to the plan of reorganization. The objections were overruled by the bankruptcy court, but were subsequently renewed, albeit in recharacterized form, in a collateral attack on the confirmation order. The Fifth Circuit Court of Appeals held that:

> We are equally convinced that the judgment of the district court ordering and confirming the sale and transfer of title of the property to Southmark are *res judicata* as to the claims asserted by appellants. The

test in this Circuit for determining whether a claim is barred by the doctrine of *res judicata* is as follows:

> "For a prior judgment to bar an action on the basis of *res judicata*, the parties must be identical in both suits, the prior judgment must have been rendered by a court of competent jurisdiction, there must have been a final judgment on the merits and the same cause of action must be involved in both cases [citations omitted] . . . ."

> Although appellants assert that Craig was not a party to the reorganization proceedings, . . . Craig — as a stockholder of the debtor corporation — possessed a statutory right to be heard "on all matters arising in" the proceedings. [Citation omitted]. The record does show that Craig was actively involved in the reorganization proceedings. By participating in the proceedings, Craig became a party to them, regardless of whether he was formally named as such. [Citation omitted].
>
> Moreover, even if Craig were not a party to the reorganization proceedings, a final judgment is *res judicata* not only between parties to the earlier lawsuit, but also their privies. [Citation omitted]. Because Craig, as a major stockholder in appellant corporation, its president, and a guarantor on the construction loan, had a strong and direct pecuniary interest in the outcome of the reorganization proceedings, . . . he is bound by the reorganization orders. [Citation omitted].

742 F.2d at 869-70. The instant Petition is no less a veiled collateral attack on the confirmed Amended Plan of WFDR.

Contrary to Petitioners' assertion that *Southmark Properties* is distinguishable, Petitioners were a "party in interest" to the WFDR reorganization proceeding and are bound, as are all other such parties in interest, by the terms

and conditions of the Amended Plan. As an equity security holder in WFDR, Petitioners were a party in interest to the confirmation proceedings by definition under 11 U.S.C. § 1109.

Petitioners' participation in the proceeding and their pecuniary interest in the outcome further indicate their role as a party in interest. Similar to the objecting party in *Southmark Properties*, Petitioners took an active and aggressive role in contesting various stages of the reorganization process, including confirmation of the Amended Plan. Individually or through attorneys, Petitioners received notice of all proceedings, appeared at court hearings and filed numerous pleadings.

Petitioners should not be heard to complain at this date, seven years after confirmation of the Amended Plan, that their due process rights were in some unarticulated and inestimable fashion violated. Petitioners' mistaken assumption that the filing of the individual Chapter 11 proceeding automatically stayed consummation of the Amended Plan and made an appeal of the confirmation order unnecessary, is perhaps unfortunate, but such neglect or ignorance of legal rights and responsibilities, particularly when Petitioners were represented by competent counsel, does not serve to annul or abrogate the binding *res judicata* effect of the Amended Plan.

This Court in *Stoll* v. *Gottlieb* held that even a plan of reorganization which erroneously discharged certain personal guaranties was, nonetheless, *res judicata* and stated:

> Courts to determine the rights of parties are an integral part of our system of government. It is just as important that there should be a place to end as that there should be a place to begin litigation. After a party has his day in court, with opportunity to present his evidence and his view of the law, a collateral attack upon the decision as to jurisdiction there

> rendered merely retries the issue previously determined. There is no reason to expect that the second decision will be more satisfactory than the first.

305 U.S. 165, 172 (1938).

The decision below is entirely consistent with the decisions of this Court and is based on settled law. Indeed, other than an attempt to distinguish *Southmark Properties*, Petitioners have not cited any authority which is relevant to the *res judicata* issue.

B. Consummation of the Amended Plan did not violate the automatic stay imposed by the filing of Petitioners' Chapter 11 petition.

Petitioners' principal argument is that the bankruptcy court had no jurisdiction to enter orders affecting Petitioners' stock, including the order confirming the Amended Plan, because the stock was under the exclusive jurisdiction of the United States Bankruptcy Court for the District of Nevada and was protected by the automatic stay pursuant to 11 U.S.C. § 362. The theme running through Petitioners' argument is that the automatic stay imposed by the Chapter 11 proceeding completely prohibited cancellation of the stock and thereby precluded consummation of the Amended Plan.

Petitioners continue to rely on an incorrect, overliteral interpretation of the legal effect of the automatic stay of 11 U.S.C. § 362. Petitioners' protestations to the contrary notwithstanding, the automatic stay imposed by the filing of Petitioners' Chapter 11 proceeding in the United States Bankruptcy Court for the District of Nevada stayed only certain direct acts against Petitioners' property, including several foreclosure proceedings then pending against Petitioners. The automatic stay is not so all-encompassing or unlimited as to apply to every conceivable act, no matter how tangenital the effect on property of a debtor. *See Avelline & Bienes* v. *M. Frenville Co. Inc.*, 744 F.2d 332, 334 (3d Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985); *In re Continental Airlines, Inc.*, 61 B.R. 758, 776 (S.D. Tex. 1986).

As a shareholder, Petitioners had certain rights in WFDR, including the right to receive a distribution of the residual value of WFDR after all claims and debts were satisfied. The cancellation of the stock pursuant to the confirmed Amended Plan did not impair or abrogate those rights because Petitioners received certificates of interest evidencing entitlement to the net proceeds generated from consummation of the Amended Plan. A distribution of such proceeds was made in Petitioners' favor to their attorneys with the knowledge, acquiescence, and express consent of the United States Bankruptcy Court for the District of Nevada. Petitioners directly benefitted when their attorneys were paid from the proceeds of the newly issued stock of WFDR.

Cancellation of stock, whether by plan or reorganization, merger, stock purchase agreement, or otherwise, is not an act that falls within the proscriptions of 11 U.S.C. § 362. A stock certificate is nothing more than a piece of paper evidencing an interest in the equity of the corporation. By virtue of the stock certificates, Petitioners' owned a bundle of rights to a distribution of the residual value of WFDR only after all claims against WFDR were satisfied. *Evans* v. *Stockton & Hing (In re Southwest Restaurant Systems)*, 607 F.2d 1243 (9th Cir. 1979), *cert. denied*, 444 U.S. 1081 (1980). The certificates of interest gave Petitioners exactly the same bundle of rights. Petitioners' property rights were not altered by the mere change in the physical piece of paper representing those rights. Petitioners held the same bundle of rights pre-petition, the same bundle of rights prior to confirmation of the Amended Plan, and the same bundle of rights subsequent to confirmation and consummation of the Amended Plan.

Corporations acting within the scope of their charters and state law should not be obligated to seek relief from the stay to perform ministerial functions such as stock cancellation, stock splits, declaration of dividends or other corporate acts that may affect price or equity shares. Respondents have located no case or statutory authority evidencing such a responsibility. Cancellation of shares by a debtor corporation

and reissuance of new shares of the reorganized company in exchange for new consideration are among the most common forms of corporate reorganization. *See, e.g., Southwest Restaurant Systems* v. *Grace*, 607 F.2d 1248 (9th Cir. 1979); *In re Evans Products Co.*, 65 Bankr. 870 (S.D. Fla. 1986); *Central States, Southeast & Southwest Areas Pension Fund* v. *Central Transport, Inc.*, 68 Bankr. 95 (M.D.N.C. 1986), *appeal dismissed*, 841 F.2d 92 (4th Cir. 1988); *In re Compass Van & Storage Corp.*, 68 Bankr. 1007 (Bankr. E.D.N.Y. 1986); *Beverages International, Ltd.* v. *Schenley Affiliated Brands Corp.*, 61 Bankr. 966 (Bankr. D. Mass. 1986); *In re Rath Packing Co.*, 55 Bankr. 528 (Bankr. N.D. Iowa 1985); *In re Toy & Sports Warehouse*, 37 Bankr. 141 (Bankr. S.D.N.Y. 1984); *In re Blanton Smith Corp.*, 37 Bankr. 300 (Bankr. M.D. Tenn. 1983); *In re Tamarack Trail Co.*, 25 Bankr. 259 (Bankr. S.D. Ohio 1982).

The issuance of the certificates of interest constituted merely a transformation or substitution of the tangible evidence of Petitioners' interest in WFDR, not an interference with or act to gain possession of any of Petitioners' property. Accordingly, cancellation and replacement of the stock certificates with the certificates of interest, pursuant to the provisions of the confirmed Amended Plan, did not violate the stay imposed by 11 U.S.C. § 362 in the Petitioners' individual Chapter 11 proceeding.[5]

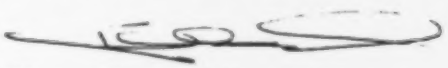
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[5] The arguments contained at pages 45-47 of the Petition do not warrant response.

CONCLUSION

For the foregoing reasons, the Writ of Certiorari should be denied.

Respectfully submitted,



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CERTIFICATE OF SERVICE

The undersigned hereby certifies that I have served the requisite number of copies of the foregoing Brief in Opposition on Jack R. Whitehorn and Mary Ruth Whitehorn, Petitioners, 5141 Indian River Drive, Box 377, Las Vegas, Nevada, 89103 by placing same in the United States Mail, first class postage prepaid, this 15 day of November, 1988. I further certify that all parties required to be served have been served.



Kenneth L. Millwood